

The University of Chicago

THE CHICAGO STOCK EXCHANGE

A PART OF A DISSERTATION SUBMITTED TO
THE FACULTY OF THE DIVISION OF THE
SOCIAL SCIENCES IN CANDIDACY FOR
THE DEGREE OF DOCTOR OF PHILOSOPHY

DEPARTMENT OF SOCIOLOGY

1937

By
FRANCIS ELLSWORTH MERRILL

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THE ROLE OF THE STOCK EXCHANGE IN THE
METROPOLITAN COMMUNITY

The Nature of the Stock Exchange

A stock exchange is an institution whose members come together at regularly constituted intervals for the purpose of dealing in certain securities in accordance with definitely prescribed rules. The primary function of a stock exchange is to provide the mechanism whereby buyers and sellers of securities may establish contact with one another through the medium of brokers. This institution lends itself admirably to a functional description; in the literal sense of the word, the stock exchange is what it does. Its institutional character is determined by the function which it performs in the socio-economic life of our pecuniary and corporate culture. The stock exchange serves as a clearing house through which the certificates of ownership or indebtedness of corporate enterprises are distributed and capital is enlisted for the development of those countries which have already been industrialized, and for the exploitation of undeveloped countries. The stock exchange also provides an exact measure of corporate worth which serves as an important basis for the contemporary credit structure.¹

The sociologist is interested in the stock exchange both because of its form and its function. The stock exchange is a social institution with a definite role in the metropolitan community. This institutional structure has grown up about a distinct type of social relationship, which in turn has arisen from the complicated financial needs of a corporate society. Persons come

¹George Soule, "The Stock Exchange in Economic Theory," The Security Markets (New York: Twentieth Century Fund, Inc., 1935); Marcus Nadler, "Stock Exchange," Encyclopaedia of the Social Sciences (New York: The Macmillan Company, 1934); A.A.Berle and Gardiner C. Means, The Modern Corporation and Private Property (New York: The Macmillan Company, 1933), pp. 290-291; N.S.B.Gras, An Introduction to Economic History (New York: Harper and Brothers, 1922), pp. 248 ff.; James A. Ross, Speculation, Stock Prices and Industrial Fluctuations (New York: The Ronald Press, 1938).

together on the stock exchange in order to conduct a highly specialized type of human activity. As a result of this concentration of people at stated times over an extended period, certain rules and regulations grow up, some of them spontaneous and unwritten, others formal and codified. These regulations apply to the relationships between the members of the exchange themselves, between the members of the exchange and the speculative public, and finally between the general public and the exchange as an institution. The stock exchange thus illustrates the phenomenon of social control in a variety of manifestations.²

The sociologist is also interested in the relationship of the stock exchange to the social economy of a particular metropolitan region. The stock exchange represents a stage of metropolitan economy that is relatively far advanced from the pioneer stages of commercial and industrial development. Those regions which are still in a relatively simple stage of economy cannot accumulate the surplus in cash or credit which calls for the issue and organized marketing of securities on a stock exchange. Industry and commerce in the newer regions are financed by capital coming from regions that are more developed economically and have been able to accumulate capital over and above their current needs. The United States stood in this relationship to Great Britain during the decades 1820-1880, when the capital market of the latter nation was supreme. The New York Stock Exchange was in a subordinate position with regard to the London Stock Exchange during this period. The Chicago Stock Exchange has been in a similar position with regard to the New York Stock Exchange from the foundation of the former institution to the present time.³

The sociologist is still further interested in the implications of the stock exchange for the social economy as a whole. With modern methods of high speed communication, the stock exchange offers an example of human activities carried on at great distances and for a variety of human motives. An individualistic economy

²Francis E. Merrill, "The Stock Exchange and Social Control," American Journal of Sociology, XLIII (January, 1938), 560-74. This article is reproduced in its entirety below as the second half of the essential portion of this dissertation.

³Bureau of Business Research, Investment Banking in Chicago, University of Illinois Bulletin No. 39 (1931); Bureau of Business Research, Chicago as a Money Market, University of Illinois Bulletin No. 17 (1928).

places a high premium upon activities that are carried on according to certain pecuniary standards. In the conduct of these speculative activities, the participants are animated by a like purpose (i.e., making money), but they lack a common purpose. This lack of a common consensus on the important affairs of human life is a striking characteristic of contemporary culture. The stock exchange is thus a focal point for many of the manifestations and contradictions of our society. It is both a symbol of capitalism and one of its most characteristic institutions.⁴

Centralization of the Security Markets

We may now turn to a more extensive investigation of the specific function which the stock exchange plays in the ecological structure of the metropolitan region. This investigation is complicated by the nature of stock exchange activities themselves.

The nature of security dealings is such that a single central market tends to arise in a given economy, where prices are made which are standard throughout that economy. Securities are highly mobile and consequently there is no such problem of shipping costs as is to be found in the case of practically every other commodity which is traded in the modern world. Prices of securities listed on the central exchange are established there because persons wishing to buy or sell these securities tend to converge upon the central market. The speed of communication is such that persons in all parts of the country are able to carry out transactions in the central market with the delay of only a few moments between the time the order to buy or sell is entered and the time it is consummated in the central market.⁵

The New York Stock Exchange is the central market for securities in the United States. This dominance has been gained by a unique combination of circumstances which have been largely the spontaneous and natural forces of an expanding economy. This phenomenon is one of the most complex in the entire socio-economic structure, involving as it does the entire system of production and distribution in the United States, the rise of foreign trade,

⁴Merrill, "Speculation in a Secular Society," Sociology and Social Research, XXIII (January-February, 1939), 257-265.

⁵Melchior Palyi, The Chicago Credit Market (Chicago: University of Chicago Press, 1937), chap. iii.

and the resultant concentration of banking and trading funds in the metropolis. The security markets are intimately related to the concentration of banking funds. The combination of banking and trading functions in one metropolitan center has occurred only once in the history of the country. The dominance of the New York Stock Exchange is thus the combined result of such factors as traditional prestige, ecological position, the centralization of big business, the growth of subsidiary financial institutions, and the presence of experts and specialists in financial transactions. This dominance has never been seriously threatened by any other city since it became firmly established. Financial dominance is one of the most stable types of secular power.⁶

The New York money market is also the premier market for the issue of new securities. With a few exceptions,⁷ the major investment banking firms have their main office in New York and the bulk of security originations of large issues come from there. In the years 1921 to 1930, Chicago investment bankers were principals in a relatively small percentage of the total originations in the country, the proportion ranging from 5.9 per cent of the total in 1921 to 11.8 per cent of the total in 1927. In the speculative boom of 1928-1930, Chicago investment bankers originated less than 10 per cent of the total for the country as a whole.⁸ The stock exchange and the issue function of the investment banker operate in close conjunction with one another. Investment bankers desiring national distribution for their securities seek the exchange with the largest concentration of buying power and the widest distribution of trading facilities. The exchange increases in importance as large issues are continually listed and traded there, while the smaller exchanges continue largely as a market for local securities in which the national interest is but slightly developed.

⁶ Benjamin H. Beekhart and James G. Smith, Sources and Movements of Funds, Vol. II, The New York Money Market (New York: Columbia University Press, 1931).

⁷ Halsey, Stuart and Company, Glore Forgan and Company, and A. G. Becker and Company are among the relatively few important investment banking houses whose main office is in Chicago.

⁸ Adapted from "The Commercial and Financial Chronicle," in Investment Banking in Chicago, p. 30. Participations, on the other hand, for the Chicago market run considerably higher in relation to the country as a whole, indicating that the Chicago region is a rich one for the purchase of securities, but that its importance as an originating center is considerably less.

The New York Stock Exchange has continued to expand in speculative importance, while the Chicago Stock Exchange has grown only slightly through conjunction with the issue business of the Chicago market.

The role of the stock exchange in the metropolitan community is thus of two general types: first, the unique role played by the New York Stock Exchange as the center of dominance for all important security speculation in the United States, with certain exceptions; second, the role played by the local or regional markets in the other large cities throughout the country. This ambivalent role is necessarily one of dominance and subordination, dominance on the part of the New York Stock Exchange and subordination on the part of the local exchanges. Nevertheless, the role of the local exchanges, although a distinctly subsidiary one, is necessary to the corporate economy of the local region and also to that of the country as a whole. We shall consider the nature of this regional role in some detail, using the Chicago Stock Exchange as a typical example.

The Role of the Local Exchange

The Chicago Stock Exchange has served as the mechanism for distributing the securities of many of the important industries in the Chicago region. The Exchange is highly conscious of this role as a regional market, particularly since many of the corporations with national distribution are moving to the New York Stock Exchange. Every effort has been made in recent years to develop this regional function of the Exchange by those members of its permanent staff whose task it is to see to the "unfinished business" of the institution. It is reasonable to assume that the future of the local exchange depends upon the extent to which they can develop these local securities and provide an active market for them, since securities with a national distribution will continue to gravitate to New York.⁹

The first Chicago Stock Exchange grew out of a need that was definitely transitory and which had but slight relationship to the function which the exchange performs at the present time. This need was for some market for trading in gold in the last days of the Civil War; the immediate reason for this gold market was that the price of all commodities traded on the Chicago Board of Trade

⁹Frank P. Smith, "The Future of Small Securities Exchanges," Harvard Business Review, XIV (Spring, 1936), 360-69.

varied with the price of gold.¹⁰ The men who met together on January 5, 1865 to found the first Chicago Stock Exchange were all connected with the Board of Trade in one capacity or another; the Exchange had its origin as an adjunct to the Board of Trade.¹¹ This relationship of subordination in local speculation has been maintained to a considerable extent up to the present time, although the speculative media dealt in by the two organizations have remained largely separate.

The presence of the Chicago Board of Trade as the principal speculative market in Chicago has thus tended to minimize the relative importance of the Chicago Stock Exchange as a regional market. The most important speculators in Chicago have for the most part either operated in the grain market, or if they have operated in stocks have done so on the New York Stock Exchange. A number of important brokerage houses in Chicago started as grain brokers and took up security trading later. Others operate at the present time in both stocks and grain. Another factor which has militated against the development of the Chicago Stock Exchange in this connection has been that a number of large Chicago brokerage firms operate in a correspondent relationship with New York firms. The arrangement has been that the New York firm would give its Chicago correspondent all of its grain business and the Chicago firm would in turn give all of the stock business it could to the New York firm, to be transacted on the New York Stock Exchange. This type of reciprocity clearly did not further the development of the Chicago Stock Exchange.¹²

¹⁰ The trading in gold on the New York Money Market stimulated the development of the device which ultimately became the stock ticker. The first quotations carried on the embryonic ticker from 1867 until about 1870 were the changing prices of gold. Western Union Telegraph Company, Outline of the History of Quotation Tickers.

¹¹ Wallace Rice, The Chicago Stock Exchange: A History (Chicago: Committee on Library of the Chicago Stock Exchange, 1928), p. 11.

¹² The Economist, LXXXII (July 13, 1929), 2. The Chicago Stock Exchange enjoyed a brief period of independence from the dominance of the Chicago Board of Trade in the summer of 1929. A merger of the two institutions had been tentatively suggested by the Board of Trade and refused by the Stock Exchange. A brief and acrimonious controversy ensued between the two institutions, which ended when the Board of Trade agreed not to trade in any securities listed on the Stock Exchange. The market break which occurred in the fall of 1929 tended to minimize the importance of stock trading

A glance at the historical function of the Chicago Stock Exchange will confirm the fact that it has served as a market for the securities of companies in the Chicago region. The early list of the Exchange was predominantly made up of the stocks of the public utility and street railway companies which served as the prime speculative favorites in the decade of the 1880's. The decade of the 1890's saw an increase in the number of securities of local and regional industries listed and actively traded on the Chicago Stock Exchange. Several breweries listed their securities on the local board, while many local industrial enterprises did likewise. In the early decades of the 1900's, the street railways continued to play an important part in the speculative machinery, both as to stocks and bonds. Approximately fifty per cent of the bonds traded on the Chicago Stock Exchange in the year 1905, for example, were those of the local street railway companies, with the remainder composed largely of local utilities and industrials.¹³

An examination of the securities traded on the Chicago Stock Exchange at any period in its subsequent history further demonstrates the fact that this market has basically been one for local or regional securities. This does not mean that securities with a national or an international distribution have not been listed and actively traded on the local exchange. Even when this situation has been present, however, the bulk of these nationally distributed securities have also been listed on the New York Stock Exchange and their market has been made there. At the height of the speculative activity in 1929, for example, four of the five leading stocks on the Chicago Stock Exchange in point of activity were those of companies intimately associated with Chicago and the Chicago region. Middle West Utilities, Grigsby Grunow Corporation (makers of Majestic Radio), the Chicago Corporation, and Borg Warner were companies which have always been associated with Chicago and the Chicago region. The Cities Service Company was the only definitely non-Chicago company in the front rank of speculative activity on the local exchange at that time.¹⁴

as compared to grain trading. The Chicago Stock Exchange resumed its role as the subordinate speculative institution in Chicago. Cf. The Economist, LXXXII (August 3, 1929), 5; ibid., August 31, 1929, p. 9; ibid., September 14, 1929, p. 11.

¹³Commercial and Financial Chronicle, LXXX (January 21, 1905), 198.

¹⁴Although the central offices and major operations of this company were not in the immediate Chicago region, many millions of its shares were owned by persons who were in this region.

A final demonstration of the predominantly local character of the Chicago Stock Exchange is furnished by an examination of the companies traded in some volume during a recent representative year. In the year 1934 there were 131 companies whose stock was traded on the Chicago Stock Exchange in a total volume of 3,000 shares or more. Of this group of active companies, 69 list Chicago as the place of their home office, 43 list one or more plants in the city limits of Chicago, and at least 15 more have a plant located in the immediate Chicago area but outside of the city proper. These companies are all located in the Chicago Metropolitan Area as that area is defined by the United States Census of Manufactures; it consists of five counties in Illinois and one in Indiana.¹⁵

Local securities are almost by definition the issues of companies whose activities are confined to a relatively small region and whose capital needs are not great. Of the 131 companies with a yearly volume of more than 3,000 shares, 44 had net tangible fixed assets of less than one million dollars. Both the number and proportion of the small companies would be increased if all the companies listed on the exchange had been examined in this connection, inasmuch as the larger companies are more able to generate public interest in their securities. The smaller companies, by the same reasoning, are liable to remain in comparative speculative obscurity. Of the 324 securities listed on the Chicago Stock Exchange on February 6, 1935, only 41 were in issues of more than one million shares, while 118 were in issues of less than one hundred thousand shares. This indicates the comparatively small character of the majority of the companies whose securities are traded on the local market. Interest in these securities is confined to an area which is relatively circumscribed. The business and banking connections of these smaller companies, their officers and directors come in the majority of instances from the immediate Chicago region. The commercial banks in Chicago provide the short-term funds for the great majority of these local industries. Many of their long-term obligations are distributed through the medium of the Chicago Stock Exchange.

Closely related to the function of providing a market for local securities with a predominantly local interest is that of providing a proving ground or experimental market for the securities

¹⁵U. S. Bureau of the Census, Fifteenth Census of the United States: 1930. Census of Manufactures: 1929, Vol. III (Washington: Government Printing Office, 1933), Map E.

of companies with a wider field of operations. These securities are not yet sufficiently known to the investing and speculative public to ensure their immediate success if they were listed on the New York Stock Exchange without preliminary seasoning. The local exchange thus plays the role of speculative pioneer, whereby new companies in untried fields may come into the industrial structure and the speculative market by easy stages. A significant result of this pioneering function is that the cyclical price fluctuations on the Chicago Stock Exchange are much greater than are those on the New York Stock Exchange.¹⁶ In like manner, the cyclical fluctuations on the Chicago Stock Exchange from the point of view of share volume of securities traded were much greater than were those of the New York Stock Exchange. As a general result of the experimental role of the local exchange, therefore, it follows the speculative cycle of the New York Stock Exchange to a highly accentuated degree.¹⁷

The role of experimental station is not an unmixed blessing to the members of the Chicago Stock Exchange. The most active and hence most profitable stocks are constantly being removed to the New York Stock Exchange after a market has been laboriously developed for them in Chicago. Of the score of stocks listed both on the Chicago Stock Exchange and the New York Stock Exchange in 1934, the most active were without exception listed on the Chicago Stock Exchange first and had their market developed there before moving to New York. This does not mean that the Chicago Stock Exchange loses the market on securities completely after they have moved to the New York Stock Exchange. There is often a comparatively heavy trade in the security in Chicago even after it has moved to New York. This situation applies particularly to such securities as Marshall Field and Company Common, Bendix Aviation Corporation, the Walgreen Company, and other companies which have traditionally been associated with Chicago and which continue to carry on the bulk of their business in the Chicago region. Connections are still maintained in the developmental market, even after it has fulfilled the developmental function.

¹⁶ Palyi, op. cit., pp. 68-69.

¹⁷ Measured in share volume, the Chicago Stock Exchange has experienced more violent fluctuations in the past ten years, both on the boom side and the depression side, than is the case of the New York Stock Exchange. Palyi, op. cit.

The local stock exchange also serves as a market for special types of securities, which because of local interest or geographical position find particular favor among the investors and speculators of certain areas. The Chicago Stock Exchange has served as an important market for utility securities for the past forty years. The street railway companies, under the skillful manipulation of Charles T. Yerkes, became prime speculative favorites on the Chicago Stock Exchange in the decade of the 1890's. This speculative interest was in part a result of the tremendous physical expansion of the city of Chicago and the complete dependence of a majority of the population upon such means of transportation.¹⁸

A shrewd combination of publicity and pressure group activity was involved in the manipulation of the street railway securities. Publicity was furnished by practically every means for the dissemination of news in Chicago. Pressure group power was applied through political control of the city council and other administrative agencies of the city. These same techniques were later applied by another and even more important figure in the speculative life of Chicago -- Samuel Insull. This financier dominated many important political groups in the city and the state, controlled certain public services which were vitally necessary to the people as a whole, overcapitalized the companies providing these services, and sold the securities to the eager public. This combination of circumstances could be substantially duplicated by the experience of many other large cities in the country whose local stock exchanges served as the market for the securities of the local public utilities.

The Chicago Stock Exchange has developed another group of specialties which have served as important speculative media for the member brokers and their customers. These specialties are the stocks of the automobile accessory companies, many of which had their first market on the Chicago Stock Exchange before they were taken to the New York Stock Exchange. The center of the automobile manufacturing business is the state of Michigan. In Indiana and Michigan there have grown up hundreds of relatively small corporations which specialize in one or more phases of the automobile

¹⁸In the year 1889, for example, the Chicago Rapid Transit Company carried 64,827,873 passengers. Homer Hoyt, One Hundred Years of Land Values in Chicago (Chicago: University of Chicago Press, 1933), p. 491.

accessory business. The list of securities on the Chicago Stock Exchange in 1935 carried sixteen stocks of companies specializing in this particular type of activity. These companies manufactured such accessories as automobile lamps, asbestos lining for brakes, starters, clutches, bumpers, radiators, cam shafts, heaters, piston rings, shutters, and numerous other highly specialized parts. A number of these securities have served as prime speculative favorites in Chicago both before and after the time they graduated to the New York Stock Exchange. Persons living in the greater Chicago region are acutely conscious of the automobile industry. It is natural that they should take a particularly active part in buying and selling the securities of companies engaged in any part of this industry.

The stocks of companies specializing in the manufacture of radios shared the speculative limelight in the Chicago market during the boom years. In the year 1935 there were eight companies in the radio business with securities listed on the Chicago Stock Exchange, but the Zenith Radio Corporation was the only one which retained its former speculative appeal. Other local exchanges could duplicate this situation with other types of securities which have served as favorite speculative media at different times in the development of the cities and regions concerned. Such a speculative demand is based upon a special knowledge of local conditions and local industries which by its very nature could not be extended over a wide area. This local factor is responsible for the relative permanence of the specialized function of the small local exchange. Small, local, and experimental business and industrial situations will continue to require a local market for their securities.¹⁹

The nature of the securities traded on the Chicago Stock Exchange serves to explain further the extreme cyclical fluctuations of the business done on that institution. Many of the special issues which are important to the Chicago Stock Exchange, notably the aforementioned automobile accessories and radios, are intimately dependent upon the business cycle. As luxuries or quasi-luxuries, these industries are subject to violent fluctuations as the purchasing power of the country available for such peripheral expenditures increases and declines. The "normal"

¹⁹Palyi, op. cit., p. 68.

sequence of the business cycle is accentuated in these companies. The accentuation is reflected in their securities, which rise and fall in price and in speculative volume more violently than does the market as a whole. Luxury industries are the subject of violent speculative activity in boom times. They are subject to equally abysmal depression in the trough of the business cycle.²⁰

The Exchange and the Metropolitan Region

The Chicago Stock Exchange is closely related to the metropolitan region by virtue of the necessary financial services which it performs. We have suggested the nature of some of these services above. It remains to point out certain indices of this region which have evolved in the concrete process of daily financial activities. The limits of this metropolitan region are perhaps best expressed by the ticker service of the Chicago Stock Exchange.

The ticker.--The stock ticker of the Chicago Stock Exchange operates on the same principles, both from the broadly functional and the mechanical point of view, as the ticker of the New York Stock Exchange.²¹ That is to say, the Chicago ticker provides information concerning market transactions on the basis of which action may be carried on at a distance from the exchange itself. In this sense the ticker provides an extension of the floor of the exchange, in that the speculator who is physically removed from the exchange is still informed of the activities taking place on the floor as rapidly as the man who is actually present.

The history of the stock ticker of the Chicago Stock Exchange indicates the extent to which information regarding its transactions has been of interest to a speculative public of varying size, located in different parts of the country. The installation of Chicago tickers followed rather closely the general volume trend of transactions on the Exchange, running the cycle from 1928 to 1934 of comparative inactivity, boom, collapse, depression, and

²⁰The situation in Chicago is further complicated by the presence of the Insull securities, which provided the most important single speculative medium in the boom and whose complete collapse in the depression heightened the speculative gloom on the Chicago Stock Exchange.

²¹"Ticker," Encyclopaedia Britannica (14th ed.; New York and Chicago, 1936); Western Union Telegraph Company, Outline of the History of Quotation Tickers; Western Union Telegraph Company, Dots and Dashes (January, 1929).

faint revival. In 1928 for the first time news of the activities of the Chicago Stock Exchange reached beyond their original bounds which heretofore had been confined to Chicago and New York. Nine cities had Chicago tickers installed by January 1, 1929. These cities were Chicago, New York, Milwaukee, Kenosha, Cleveland, Detroit, Toledo, Peoria, and St. Louis. In the year 1929, public interest throughout the metropolitan region in the activities of the Chicago Stock Exchange broadened considerably, with more coverage in many of the smaller cities, including for the first time several cities on the Atlantic Coast. During the year 1929 tickers were installed in the following cities: Springfield, Indianapolis, Cincinnati, Louisville, Minneapolis, St. Paul, Kansas City, Omaha, St. Joseph, Battle Creek, Grand Rapids, Kalamazoo, Muskegon, South Bend, Flint, Jackson, Lansing, Madison, Racine, Philadelphia, Washington, Hartford, Boston. Counting the nine cities receiving ticker service in 1928 and listed above, the range of interest in the Chicago Stock Exchange increased to 32 cities. In 1930 the activities of the exchange became of interest to speculators on the Pacific Coast, with brokers in Los Angeles and San Francisco installing tickers. In addition to these Pacific Coast cities, tickers were installed in 1930 in Davenport, Des Moines, and Aurora, making an all-time high of 35 different cities which were served by the Chicago Stock Exchange tickers. This may be considered as the largest area covered by the Chicago metropolitan region as measured by the Chicago Stock Exchange tickers.

This widespread distribution gradually resumed its primarily local character as the depression became more acute. The ticker coverage retained this local character even after depression had merged into recovery. On January 1, 1936 only eight cities (including Chicago and New York) still had Chicago Stock Exchange tickers. The remaining six were Milwaukee, Minneapolis, St. Paul, Indianapolis, Peoria, and St. Louis. Interest on both the Pacific and Atlantic coasts, with the exception of New York City, had subsided by January 1, 1934. The year 1934 saw this interest still further contracted to three cities (Milwaukee being the only city besides New York and Chicago with tickers). The cities that resumed ticker service prior to January 1, 1936, were all cities in close financial and economic relationship to Chicago and the Chicago money market. The Chicago Stock Exchange thus resumed its function as a regional market, its national ambitions abandoned at least for

the time being.²²

Market news.--The ticker is not the only source of information relative to the activities of the Chicago Stock Exchange and the companies listed and traded thereon. It is also not the only news element which might roughly delimit the Chicago metropolitan area in terms of the cities in which some interest is shown in the activities of the Exchange. Information concerning the activities of the Exchange is also sent out by a brokerage house specializing in the securities listed and traded on the Chicago Stock Exchange. This house is Paul H. Davis and Company, whose leading partner was President of the Chicago Stock Exchange in 1929 and was also the first Chicagoan to be elected to the Board of Governors of the New York Stock Exchange.

This company compiles the weekly closing prices of a selected list of stocks on the Chicago Stock Exchange and sends these figures to a selected list of newspapers in the Chicago metropolitan region where there is a reasonable assumption that there may be persons with both the funds and the inclination to trade on the Chicago Stock Exchange. Some of these cities have had Chicago tickers at one time or another, but the majority never have had tickers since they were too small to support an office of a member of the Chicago Stock Exchange. The local newspapers thus furnished the only important agency for disseminating news concerning prices on the Chicago Stock Exchange.

This information is supplied by Paul H. Davis and Company to newspapers in the following cities: Illinois -- Alton, Bloomington, Champaign, Danville, Decatur, Freeport, Galesburg, Joliet, Moline, Pekin, Quincy, Rockford, Rock Island, Springfield; Iowa -- Burlington, Cedar Rapids, Clinton, Council Bluffs, Davenport, Dubuque, Fort Dodge, Mason City, Ottumwa, Sioux City, Waterloo; Indiana -- Anderson, Bloomington, Crawfordsville, Elkhart, Evansville, Fort Wayne, Gary, Indianapolis, Kokomo, Lafayette, Logansport, Marion, Muncie, Richmond, South Bend, Terre Haute; Michigan -- Ann Arbor, Battle Creek, Bay City, Flint, Grand Rapids, Jackson, Kalamazoo, Lansing, Pontiac, Saginaw; Minnesota -- Duluth, Minneapolis, Rochester, St. Paul, Winona; Wisconsin -- Appleton, Beloit, Eau Claire, Fond du Lac, Green Bay, Janesville, Kenosha, La Crosse, Madison, Milwaukee, Oshkosh, Sheboygan, Superior, Wassau. These

²²The data on the installation of tickers were supplied by the Chicago Stock Exchange.

are the cities in which the officials of one stock exchange house have reason to expect that persons will be interested in the transactions of the Chicago Stock Exchange. A concrete, albeit somewhat rule-of-thumb, definition is thus given to the metropolitan region served by the Chicago Stock Exchange.

The Securities and Exchange Commission.--A final delimitation of the metropolitan region of the Chicago Stock Exchange is established by the Securities and Exchange Commission. The Chicago office was the second regional office to be established by the Commission. The jurisdiction of this office is interesting not only from the standpoint of the control exerted over the Chicago Stock Exchange but also in view of the fact that the regional office presents a practical administrative index to the extent of the local financial region.

The functions of the Chicago office of the Commission are in the nature of investigations of the various financial activities that are going on in the Chicago area and largely taking place away from the Exchange itself. The local office of the Commission co-operates in every possible way with the Chicago Stock Exchange, the Investors' Protective Association, the Better Business Bureau, and similar organizations in an effort to discover any fraud perpetrated in security sales in the Chicago region. The territory served by the Chicago office of the Commission includes the following states: Illinois, Wisconsin, Indiana, Michigan, Ohio, Kentucky, Iowa, Minnesota, North and South Dakota, and all of Missouri except Kansas City. This area contains ten stock exchanges: the Chicago Board of Trade, the Chicago Stock Exchange, the Chicago Curb Exchange, Milwaukee Grain and Stock Exchange, Minneapolis-St. Paul Stock Exchange, Cleveland Stock Exchange, Detroit Stock Exchange, Cincinnati Stock Exchange, Louisville Stock Exchange, and the St. Louis Stock Exchange.²³

The Chicago Stock Exchange is, from the point of view of the annual volume of trading, the dominant market in this area. This dominance is, however, more apparent than real, for the security activities of the other communities actually converge upon New York rather than upon Chicago. There is no such formal centralization of authority as there is with the Federal Reserve System, whose Seventh district centers in Chicago. The Chicago area of control of the regional offices of the Securities and

²³Chicago Tribune, February 20, 1935.

Exchange Commission is a formal and administrative area and is not based upon any natural convergence of market authority. Nevertheless, this area furnishes another significant index to the financial metropolitan region of the Chicago Stock Exchange.

The Future of the Local Exchange

The Chicago Stock Exchange is continually losing securities to the New York Stock Exchange. Some of these securities retain their listing on the Chicago Stock Exchange and others do not. The securities that go to New York are for the most part those of companies which already have considerable national reputation and which hope to develop this interest and reputation further through the facilities of the broader market. In order to maintain itself, the Chicago Stock Exchange must continually list new companies (new to the Exchange, that is) located in Chicago and the greater Chicago region and performing some profitable function in that area. The officials of the Chicago Stock Exchange are conscious of this necessity and are making every effort to increase the number of reputable companies whose securities will make profitable speculative media for the members. The institutional function of the Exchange is to trade in securities. The task of the permanent officials of this institution is to see that there is plenty of unfinished business in this connection.²⁴

The lasting and permanent function of the local exchange rests in the fact that it lists and trades a large number of securities of companies in the Chicago region which would not otherwise have a market. This function does not consist in the fact that it lists and trades a number of stocks which are also listed and traded on the New York Stock Exchange. A considerable difference exists between the function of the Exchange which is to the advantage of the financial structure of society as a whole and that which is to the advantage of the Exchange as a secular institution. It is a reasonable assumption that the business of security trading would be more efficiently transacted if the various local exchanges throughout the country ceased trading in stocks that were also listed on the New York Stock Exchange. Such a step, however, would be of great disadvantage to the members of the local exchange, who would be deprived of lucrative commissions

²⁴Everett C. Hughes, "A Study of a Secular Institution: The Chicago Real Estate Board" (Unpublished Ph.D. dissertation, University of Chicago, 1928).

on those securities which still maintain a considerable volume on the local exchange after they have moved to New York.

Our investigations suggest that the permanent socio-economic function of the Chicago Stock Exchange will be based on the extent to which it fulfills the role of a local exchange. This role will become more important when and if the industries in the Chicago region continue to prosper and expand, and when and if these companies desire listing on an organized exchange with the wider distribution which such listing tends to bring. The future of the Chicago Stock Exchange thus rests upon the future of La Salle Street. If the importance of La Salle Street as a center of long-term financing of regional companies increases, the Chicago Stock Exchange will also add to its stature. It cannot pull itself by its own speculative bootstraps.

At the present time the national dominance of the New York Stock Exchange as a central market for the principal securities of the nation is not seriously threatened by any other speculative institution. On the contrary, the importance of the New York Stock Exchange relative to the interior exchanges is steadily increasing. Under the existing circumstances, neither the Chicago Stock Exchange or any other local exchange in the country can seriously rival the New York Stock Exchange as a focal point for the speculative activities of the country. It is theoretically possible for the Chicago Stock Exchange to increase its relative proportion of the speculative stock exchange business of the country from less than one per cent to ten or fifteen per cent. This would represent a tremendous increase in the business and importance of the Chicago Stock Exchange as well as in the profits of its members, but it would still not call into question the dominance of the New York Stock Exchange. Such an increased proportion of the stock exchange business of the country must necessarily be developed by the Chicago Stock Exchange itself through introducing to its list a large number of profitable companies from within the Chicago region. It cannot be done by taking away from the New York Stock Exchange business which the older institution has built up. The reality of the one central market would not be seriously questioned, however, even if this hypothetical expansion of the Chicago Stock Exchange were to take place. Under the existing socio-economic organization of the United States, the New York Stock Exchange will continue to be the central and dominant market for securities.

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THE STOCK EXCHANGE AND SOCIAL CONTROL

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ABSTRACT

The traditionally individualistic activities of the stock exchange have given rise to various types of social control, of which the following three are outstanding representatives: (1) the control exerted by the exchange over its members; (2) the control exerted by the exchange over the companies whose securities are listed and traded through its facilities; (3) the control exerted over the exchange itself by the federal government. Regulation of the mechanics of trading in the interest of more efficient functioning has long been carried on by the exchange itself. This type of control has been augmented and improved by the Securities and Exchange Commission. Any regulation of the exchange which would destroy the principle of the free competitive market, however, would run directly counter to the most important values of contemporary society. Such drastic control would threaten the basic complex of private property and hence would be fundamentally ineffectual.

The stock exchange is the institution which most completely symbolizes the spirit of *laissez faire*. The free competitive market has traditionally been most perfectly expressed in the unrestricted operations of the security speculator, whose conduct approximates at times the calculated self-interest of the economic man. Security speculation is based upon the principle that every man has the right to act in accordance with his own best interests, provided in so doing he does not infringe too flagrantly upon the life interests of his fellows. In the stock exchange individual freedom has become institutionalized.

It is significant, however, that even in this atmosphere of supreme personal liberty men are not free from social constraint. In the course of security speculation there have arisen definite needs for social control which have brought forth equally definite control devices. The growing complexity of the world-economy, technical improvements in the mechanisms of communication, and the increasingly corporate character of modern life have combined to render more acute the need for control over this traditional stronghold of individual freedom. The right to truck and barter in the market place has come to be hedged about with innumerable regulations. The majority of these regulations have been formulated and enforced by the exchange itself in order to facilitate the intricate mechanisms

of speculation. A significant and growing number, however, are being imposed upon the exchange from without. This study is concerned with certain of these types of control as they have arisen out of the activities of a single speculative institution—the Chicago Stock Exchange.¹

For purposes of the present discussion, social control may be broadly defined as the process by which individuals are influenced by other individuals by virtue of their mutual membership in the variety of groups which make up a given society. We shall consider social control from three points of view: (1) the control exerted by the Chicago Stock Exchange over its members, as defined by the constitution and by-laws of that institution; (2) the control exerted by the Exchange over the companies whose securities are listed and traded through its facilities; (3) the control exerted over the Exchange itself by the general public, acting through the medium of the Securities and Exchange Commission.

These various types of control take widely different forms. They range all the way from the reciprocal claims and expectations arising out of the personal relations of the members to each other through the informal and unwritten code of ethics of the member-brokers to the formal regulations of the Securities and Exchange Commission. In a sense these diverse elements of control are functions of the various publics which operate in connection with the Exchange.² The control of the Exchange over its members is the self-discipline exerted by the immediate Exchange public, the member-brokers, in their dealings with one another and with their customers. The control of the Exchange over its listed companies is directed at another public in the speculative complex, namely, those persons who invest or speculate directly in securities and who require adequate informa-

¹ The Chicago Stock Exchange has the same general control mechanisms operative in connection with its activities as the rest of the major stock exchanges in the United States. In common with the majority of the interior exchanges, the Chicago Stock Exchange has followed closely the dominant example of the New York Stock Exchange, not only from the point of view of the mechanisms of trading but also from the point of view of the code of business conduct which the members observe. Cf. Paul D. Dickens, "The Security Markets of the United States," *The Security Markets* (New York: Twentieth Century Fund, Inc., 1935), p. 258.

² Francis E. Merrill and Carroll D. Clark, "The Money Market as a Special Public," *American Journal of Sociology*, XXXIX (March, 1934), 626-36.

tion if they are to act with any degree of circumspection. The control over the Exchange itself by the Securities and Exchange Commission operates in the interest of a still larger public which is, for all practical purposes, synonymous with the general public.³

I. SOCIAL CONTROL OVER THE MEMBERS

The members of the Exchange are faced with a difficult problem of control over their own actions. They must so regulate their dealings on and about the Exchange that the members will not cheat one another and at the same time impose only those restrictions which will not interfere with the maximum freedom of trading. They must insure fair dealings with one another without jeopardizing the free competitive play of the market, which has as a basic premise the assumption that each individual will act in his own best interest and will take such advantage of his competitors as he is able. Hence the dilemma of self-discipline on the stock exchange, involving, on the one hand, a minimum of regulation necessary to conduct a market at all, and, on the other, the maximum free play of individual resources, skill, and initiative.

The majority of the regulations imposed by the members upon themselves are concerned with the mechanics of trading and with those necessary details connected with the buying and selling of securities in an organized market which have to be standardized in order to insure its orderly functioning. These regulations do not, for the most part, involve fundamental issues such as the right of one broker to profit unduly at the expense of a fellow-broker or customer, the ethical implications of pool manipulations to raise or lower the price of securities, or the question of profiting from inside information which by definition is not the property of the speculative public as a whole. These and many other similar rights are taken for granted by the very nature of security speculation. They are an integral part of the financial mores, values never seriously questioned by the members of the Exchange or the financial community in which they operate. There are, of course, certain fundamental issues which

³ The major financial institutions of the country, particularly the banks and insurance companies, are intimately related to the security markets. For a discussion of this relationship cf. William H. Steiner, "Effects of Security Markets on Institutional Investors," *The Security Markets*, chap. vi.

have been explicitly met by formal statement in the written code of the Exchange. But, broadly speaking, the elements of self-discipline imposed by the members of the Chicago Stock Exchange are marginal to the real function of speculation which is to make money for the speculators. This function is a natural outgrowth of the culture which has produced the stock exchange and whose most characteristic symbol the stock exchange continues to be.

Certain recurrent situations have arisen in the course of trading in securities many years before the Chicago Stock Exchange was founded. Definitions of these situations were worked out by the members of the New York Stock Exchange and others before them by the painful process of trial and error. These definitions were incorporated in the constitution and by-laws of the New York Stock Exchange, whence they were taken over in large part by the Chicago Stock Exchange and other interior exchanges in the country. The signature of each member of the Chicago Stock Exchange to his own constitution and by-laws is a guaranty that he accepts these definitions and agrees to abide by them. This relationship, of which representative instances will be cited, is somewhat similar to that by which the members of the Chicago Real Estate Board bind themselves to deal fairly with their colleagues in the market.⁴

Members of any stock exchange are dependent for a large share of their income upon the commissions paid to them by their customers. The Chicago Stock Exchange is no exception.⁵ It is to the advantage of the members of the Exchange to keep their customers solvent so that they may continue to speculate and pay commissions. The general speculative public is notoriously "bullish," and many more persons buy stocks in the hope of an advance than sell stocks "short" in the hope of a decline.⁶ A deflated and demoralized

⁴ Everett C. Hughes, *The Growth of an Institution: The Chicago Real Estate Board* (Ph.D. diss., University of Chicago, 1928; Society for Social Research of the University of Chicago, Ser. II, Mono. 1 [1931]).

⁵ During the years from 1928 through 1933 commissions made up from 59 per cent to 72 per cent of the total income of the members of the Chicago Stock Exchange. The percentage variations are an index of the degree of public participation in the market in the various years (United States Senate, *Hearings on Stock Exchange Practices* [Washington, 1934], Part XVII, p. 7903).

⁶ Lincoln Steffens comments on this traditional optimism of the speculative public

market accordingly wipes out speculative accounts of customers and deprives brokers of further commissions. Deliberate demoralization of the market ("bear raiding") is therefore disastrous to brokers and customers alike.

In order to eliminate as completely as possible the practice of deliberate demoralization, the Exchange has formulated drastic regulations against it. The most important of these regulations applies to "purchases or sales of securities . . . made for the purpose of upsetting the equilibrium of the market or bringing about a condition in which prices will not fairly reflect market values."⁷ This regulation nominally applies not only to those members who artificially depress the market but also to those members who artificially raise the price of any security. In actual practice action is rarely taken against such persons unless they carry on their operations in a particularly flagrant manner.⁸ Few questions are asked by the members as long as the public is participating in the market, commissions are coming in, and at least a semblance of a free market is maintained in any given security.⁹

An important consideration in the study of social institutions is the variety of roles which the members play toward one another, toward the institution itself, and toward the general public. In order to insure the efficient functioning of the institution these roles should be clearly defined at all times, with no ambiguity as to the role the member is assuming in a particular situation.¹⁰

in his firsthand observations of the panic of 1893 (*Autobiography* [New York: Harcourt, Brace & Co., 1931], pp. 187 ff.).

⁷ *Constitution and By-Laws of the Chicago Stock Exchange* (reprinted November, 1933). The phrase "market values" is an extremely elastic one and is used here in a question-begging sense. Market values are defined by the market and hence logically any price the security may bring in the market is its "market value."

⁸ The Securities and Exchange Commission has brought several actions against persons believed to have artificially raised the price of a given security through market manipulations. Such actions up to this time have proved somewhat inconclusive because of the difficulty of first defining and then proving irregularities of this kind.

⁹ A striking case in which no such questions were asked occurred in the market history of Insull Utility Investments, Inc., which offers a clear case of interference with the equilibrium of the market (cf. United States Senate, *op. cit.* [Washington, 1933], Part V, pp. 1703-4.)

¹⁰ Hughes, *op. cit.*

The member of the Exchange who deals with the speculative public must do so in the role of a member of a partnership rather than as an agent of a corporation. This distinction is a natural outgrowth of the law of partnerships and corporations under which the partner is personally liable for all of the obligations contracted by the partnership. The agent of a corporation does not have such an obligation. By order of the Exchange each member must assume a definite role in his dealings with other partners, with the officers of corporations, and with other individuals who are neither partners nor officers. These roles must be kept distinct at all times.¹¹

This regulation is applied only to members who might become associated in a corporate capacity with companies dealing in stocks, bonds, or other investment securities. The Exchange is an institution which specializes in dealing in such types of negotiable instruments. Its institutional concern lies only in the conduct of its members which pertains to these specialized instruments. Its interest is thus highly specialized and applies only to that narrow segment of the members' lives which has to do with the purchase and sale of securities. The Exchange is not officially concerned if its members hold office in corporations dealing in meat-packing, dry goods, or public utilities. Still less does the Exchange attempt to define the religious, political, or recreational affiliations of its members.

A bucket-shop is an illegal institution which poses as a reputable brokerage house but in which spurious transactions in securities are carried on. Customers are encouraged to deposit money or securities with the representatives of the organization with the understanding that the latter will purchase securities for the account of the customer on a reputable exchange. The operators of the bucket-shop do not make the reputed purchases but rather wager with their customers on the prices of the securities which they claim to have pur-

¹¹ The official historian of the Chicago Stock Exchange comments on this relationship as follows: "As a membership is a personal privilege, he cannot be admitted as an officer or employee of a corporation dealing in investment securities which, lacking actual personality and its stockholders having only limited liability, cannot be bound by the rules of the Exchange . . ." (Wallace Rice, *The Chicago Stock Exchange* [Chicago: Chicago Stock Exchange, 1928], p. 68).

chased. Eventually they will pocket the deposits of the customers and decamp.¹²

Reputable brokers and exchanges are naturally opposed to such activities because they prejudice the speculative public against legitimate establishments. Furthermore, "commissions" paid the bucket-shop operators on purchases supposedly made on the exchange never find their way into the pockets of the members. The Exchange has therefore legislated drastically against the participation or co-operation of its members in such operations. Thus

any member of this Exchange who is interested in, or associated with, or whose office is connected, directly or indirectly, by wire or other method or contrivance, with any organization, firm or individual engaged in the business of dealing in differences or quotations on the fluctuations in the market price of any commodity or security, without a bona fide purchase of such commodity or security in a regular market or Exchange, shall be deemed to have committed an act detrimental to the interest and welfare of the Exchange.¹³

In addition to eliminating member-participation in the bucket-shop (which it does not mention by name), this regulation is designed in the interest of the good name of the Exchange itself. This institution does not wish security speculation to be confused in the public mind with "pure gambling," but rather wishes to retain the role of an institution in which transactions are carried on which are based on sober and mature judgment.

II. SOCIAL CONTROL OVER LISTED COMPANIES

The Exchange exercises a certain regulatory control over the corporate units in the financial structure which seek listing with it. The nature and financial solidarity of the companies whose securities are traded on the Exchange are clearly a matter of great importance to the members and their customers. The Exchange therefore takes careful precautions against palpable fraud by requiring an extensive series of schedules to be filled in before admitting the securities of any company to trading. By insisting on this information the Exchange exercises a definite supervisory control over the corporate personalities of the listing companies.

¹² Dickens, *op. cit.*, p. 252.

¹³ *Constitution and By-Laws of the Chicago Stock Exchange.*

The disclosures that the company makes through the mechanism of the Exchange are necessary to the correct market appraisal of the security in question.¹⁴ They are the most important elements in the formation of market attitudes on the part of buyers and sellers. The listing corporations or their bankers are naturally interested in presenting the affairs of the company in the most favorable light possible. One of the most important functions of the Exchange (and later the Securities and Exchange Commission) has been to see to it that the truth is told in these disclosures and that unfavorable information is also made available in order that the market attitude may be correct. The Exchange in this sense is a regulatory mechanism, a watchdog of the investor.¹⁵

The information required by the Exchange prior to listing comprises such items as the total capitalization of the company, the number of shares of stock of various classes to be issued, the dividend rate, the nature and history of the business of the company, the location of the principal offices, the fiscal year and the date of the annual meeting, the preference of each class of stock as to dividends and assets in the event of liquidation, the provisions under which the stock may or may not be called or retired, the amount of funded indebtedness of the company, a list of constituent or subsidiary companies and the amount and types of securities outstanding of each of these companies, a full description of the properties of the company, including such intangible items as patent rights, processes, and "good will," and finally a series of elaborate financial statements containing a balance sheet of recent date and an income statement ending with the date of the balance sheet. In addition to the foregoing information the Exchange requires that the company furnish a number of exhibits, including a copy of the charter or articles of incorpora-

¹⁴ A. A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan Co., 1933), p. 313.

¹⁵ The Securities Act of 1933 was enacted primarily to correct the evils attendant upon the former methods of disclosing information to the public. "The Act undertook to do this by the dual method of obliging sellers of new security issues to make full disclosures of information concerning both the specific securities offered and the issuing corporation, and of placing full civil liability upon all those that play a material part in presenting this information to the public. The civil liability is imposed for the accuracy and adequacy of the information furnished" (*The Security Markets*, p. 569).

tion, a copy of the by-laws, mortgage, trust deed or indenture, opinion of counsel regarding the validity of the issue, a duly qualified appraisal, specimens of all securities to be listed, and a detailed statement of the present distribution of the securities proposed for listing.¹⁶

The complexity of this information indicates the highly specialized and technical nature of security speculation and the corresponding difficulty of its control by formal regulations imposed by law. The Exchange is not an institution dealing in simple and concrete units whose value is easily and specifically ascertainable by the ordinary processes of bargaining in the market place. The activities of the Exchange, on the contrary, are among the farthest removed of all those in our culture from the simple commercial transactions of a precapitalistic society. The information requires the collaboration of many types of specialists in legal and financial activities, notably the corporation lawyer and the certified public accountant. Both of these groups operate in a world of intangibles. Their activities are couched in a universe of discourse that is unintelligible to the layman. They form highly specialized publics within the larger special public of the stock exchange. The complexity of any effort at control of companies operating in this world of intangibles is evident, whether that control be attempted from within or without.¹⁷

In addition to the information required at the time of listing, the Exchange attempts to anticipate every possible contingency in the affairs of the corporation admitted to trading. Some of these contingencies can be foreseen by a careful examination of the information furnished at the time of listing. If a major crisis is obviously

¹⁶ This list contains a representative few of the items required by the Chicago Stock Exchange from its listing companies. It is taken from a current *Listing Application* of the Exchange, which contains the following note: "The foregoing financial statements shall truly disclose the past operations and present condition of the applicant company and shall be certified to the Chicago Stock Exchange by duly qualified independent public accountants whose certificate shall be set forth in full as part of the application. Said financial statements shall be clear and informative."

¹⁷ Few prospective buyers or sellers possess both the interest and the technical knowledge to understand much of this information in arriving at their market appraisal. The majority of investors and speculators form their market attitudes of a given security from a very few standard items, such as the earnings per share of a stock and the number of times a company earns its bond interest.

imminent in the affairs of the company, the application will in all probability be denied. If a minor crisis arises after the shares have been listed, market attitudes will change and the shares will either advance or decline. If the crisis be of such a nature that the continued solvency of the company is seriously threatened, the shares may be stricken from the list of the Exchange.¹⁸

The precise nature and completeness of this running information required by the Exchange is difficult to define accurately or consistently. As Berle and Means point out, "A corporation can hardly issue to the market a slow cinema of all its activities."¹⁹ In a certain sense the position of the company may change daily. New orders come in, old customers are lost and new ones made, new contracts are made and old ones not renewed. Important information of major changes in the fortunes or policy of the company, however, must be published promptly if an adequate market appraisal is to be maintained. Some of this information is of a routine or periodic nature, such as the announcement of earnings for specified periods or the publication of a balance sheet at stated intervals. Other information takes the form of a report to the market of a situation which cannot be anticipated and which occurs at highly irregular intervals in the history of a corporation. Such episodic information would include a sudden change in the general character of the business of a company, a drastic revision of its accounting policies, or the issue of a new stock or bond.

In concluding this brief investigation into the control practiced by the Exchange over its listing companies through the publication of information, it is significant to call attention to the information which the Exchange does not require. Much of the information which the company is required to furnish is not so important to a correct formation of market attitudes as that which they are al-

¹⁸ In recent years the Exchange has been faced with a new contingency in connection with its listing companies. This is the refusal of a company to register with the Securities and Exchange Commission. Failure to do so means that the shares of the company must be delisted from the Exchange. E.g., in the year 1935, 96 companies with a total capitalization of 32,379,638 shares were delisted by the Chicago Stock Exchange for this reason. Data taken from *Press Release of the Chicago Stock Exchange*, December 31, 1935.

¹⁹ *Op. cit.*, p. 322.

lowed to omit. Such confidential information would include all data relative to the existence of pools operating in certain stocks, the number of shares involved in the pool, the personnel of the group operating the pool, the existence of options to purchase stock at certain prices, and other such intimate material. Such information will in all probability not be published by the Exchange unless it is forced to do so, for its publication at the time it is going on would seriously curtail one of the most important elements of security trading—secrecy. Such information as is available on these matters is always *ex post facto* and hence is of purely historical interest.²⁰

The Securities and Exchange Commission has attempted to penetrate the veil of secrecy which has hitherto surrounded much of this important information of the exchange. This body has required that all listed corporations make certain important disclosures to the public, notably the number of shares held at the end of every month by the officers and directors of the company. In addition, the Commission has required the publication of the salaries and bonuses of corporate officials. The importance of this information is indicated by the extreme reluctance with which it was furnished by many large corporations. Such disclosures are important to present and potential stockholders, since they indicate matters of considerable concern to the welfare of the company of which the stockholders are the nominal owners.²¹

III. SOCIAL CONTROL OVER THE EXCHANGE

We have suggested that the stock exchange is an institution whose efficient functioning is of great importance to the general public. Recognition of this importance is of relatively recent date in the

²⁰ An example of this belated publication of important information may be seen in the testimony concerning the pool in Sinclair Consolidated Oil conducted by Arthur Cullen and others (*Hearings on Stock Exchange Practices*, Part VI, pp. 3055 ff.).

²¹ The exact nature of these disclosures are indicated as follows: "As of the close of each month every person who is directly or indirectly the beneficial owner of more than 10 per cent of any registered issue of stock or who is a director or an officer of the issuer of such stock is required to file with the Commission and the exchange a statement of the amount of each such security which he holds together with such changes of ownership as have occurred during the month" (adapted from the "Securities Exchange Act of 1934," *The Security Markets*, pp. 706-7).

United States as contrasted with many of the European nations.²² In our consideration of social control in connection with the Exchange, it remains for us to discuss the control exerted over the Exchange itself in the interests of the general public, particularly that growing out of the Securities Exchange Act of 1934. We cannot consider this question in detail and can point out only certain of its implications to the broader subject of social control.

In his first Inaugural Address, President Roosevelt promised to "drive the money changers from the temple." This promise initially received almost universal popular support, coming as it did after a period when the merchants and traders of securities had come to play so important a part in our economic life and the stock market had so long acted as the governor rather than the index of business activity. The collapse in security prices in 1929 was followed by an almost continuous decline for three and one-half years, and the public became more and more concerned. When the Roosevelt administration came to power the country was ready for drastic action.²³

The action took the form of two principal pieces of legislation—the Securities Act of May 27, 1933, and the Securities Exchange Act

²² "... The Continental exchanges are in a very real sense related to and controlled by their respective governments, this control varying in degree from that in Amsterdam, where the governmental control is more theoretical than actual and amounts to practical non-interference, to the Paris Bourse, established as a government monopoly, and the Berlin Exchange where the organization and operating practices are subject to governmental regulation. The London Exchange, in contrast to other leading foreign exchanges, is a voluntary, self-governing organization remarkably independent of governmental control and influence, and similar in this important respect to the New York Stock Exchange" (Dickens, "Foreign Stock Exchanges," *op. cit.*, p. 554).

²³ For a number of years prior to the advent of the Roosevelt administration there had been sporadic legislative attempts to regulate the sale of securities to the general public. These attempts had taken the form of state "Blue Sky" laws, which were directed against the more palpable examples of fraud in security dealings. It is significant that these regulations were carried out for the most part against fraudulent transactions away from the stock exchanges and in securities not listed on any reputable exchange. The exchanges themselves were presumed to be willing and capable of regulating their own affairs. In the work of protecting the public against fraud outside of the exchanges the various states had the co-operation of the Federal Post Office Department and the Department of Justice in cases involving the use of the mails and interstate transactions. Cf. G. Wright Hoffman, "Securities Exchange Act of 1934," *The Security Markets*, pp. 700-701.

of June 6, 1934. The former Act was principally concerned with the publication of adequate information to the investing and speculating public. In order to insure the accuracy of such disclosures the Act attempted to exercise control not only over the security dealers who originally offered the security for sale but also over those dealers who acted as intermediary agents of secondary distribution for a period of one year thereafter. Under the Act it was unlawful to offer for sale through the mails or in interstate commerce any security which had not been registered by the designated Federal agency.²⁴

The Securities Exchange Act of 1934 enlarged the power of the federal government over the exchanges of the country and supplemented the earlier Act in a number of important respects.²⁵ The Securities Exchange Act takes the point of view that the security markets are an integral part of the national economy and as such should be under the supervision and regulation of the federal government. The Act has as its general objective the efficiency of the security markets, whose function should be (1) to evaluate securities at approximately their "true values," (2) to bring about the transfer of these securities in an orderly manner, and (3) to direct the flow of capital into those industries where it will be most beneficial to the national economy.²⁶

The Act attempts to carry out these objectives by improving the mechanisms by which credit is employed in security dealings, by regulating the actual speculative machinery of the exchanges themselves, by increasing the accuracy and adequate distribution of corporate information, and finally by improving the character of over-the-counter dealings.²⁷ The exchanges are subjected to an elaborate system of supervision based to a large extent on submission of perti-

²⁴ Under the original provisions of the Act this agency was the Federal Trade Commission, but it later became the Securities and Exchange Commission.

²⁵ For a discussion of these amendments to the Securities Act of 1933 which were incorporated in the Securities Exchange Act of 1934 cf. *ibid.*, pp. 714-19.

²⁶ Hoffman, *ibid.*, pp. 701-2. These objectives are clearly ideals which can only be approximated in actual practice.

²⁷ The yearly volume of over-the-counter dealings (i.e., dealings in securities outside of organized exchanges) is estimated at from two to three times that carried on in all of the nation's exchanges combined. Control over these unorganized markets is very important but it is even more difficult than control over the exchanges.

nent information concerning their own activities, the activities of their members, and the activities of the companies whose securities are listed. Much of this information, it should be noted, was already insisted upon by the exchanges in the conduct of their own activities, so that from this point of view the control exerted by the federal government was merely an extension of that already in operation. The important consideration from the standpoint of social control, however, is that the Securities Exchange Act has required the exchanges to submit to the publication of any information concerning their activities, other than the exchanges themselves have seen fit to publish. The element of compulsion, not the information itself, is the significant fact.

The most important theoretical question suggested by this attempt at social control over the security markets is whether or not such control is possible in any fundamental sense. Regulation of the exchange from the point of view of the mechanics of trading, the publication of information, and the filing of periodic reports to the Securities and Exchange Commission is not only possible but is actually in operation. The federal government can enforce its police power over this type of interstate commerce so that many of the more obvious abuses of security speculation will be eliminated.

The question remains, however, as to the degree to which this social control can be extended. It is a reasonable assumption that the complete regulation of the security markets was never the intention of the Roosevelt administration. Even if this had been the intention, such complete regulation would be impossible without destroying the basic principles of the free competitive market. The most important of these principles is that every participant in the market, whether he be broker or customer, has the right to trade with his fellows in the interest of his own private profit. We have pointed out above certain of the necessary limitations which the Exchange itself has placed upon the business of trading so that the members will not cheat one another and the speculative public. These limitations are largely superficial in that they are merely intended to make the machinery of speculation run smoother for the ultimate profit of all concerned. The regulations of the federal government come for the most part under this same category. Any control in a more complete

sense would seriously curtail the right of the trader and speculator to make as much profit as he can and hence would interfere with the free play of the market as traditionally defined.

In other words, any drastic control by the federal government over the activities of the market would mean a regulated market. A regulated market places definite limitations upon the operations of the individual speculator and hence from the speculative point of view is no market at all. Any such change in the basic function of the securities market would in turn threaten the values which underlie the entire complex of private trade. These values are far more important as elements of social control than the speculative code, since they are always present beneath the comparatively superficial regulations of the code. The existing system of property relationships has one of its most characteristic manifestations in the business of security speculation as that activity has traditionally been defined. Under these circumstances any basic regulation of the security markets is impossible without calling into question the system of property relationships itself. Such regulation is conceived to be in the interest of the general public. It is dubious if the majority of this general public would submit to any control which would involve such drastic violation of their fundamental values.

DARTMOUTH COLLEGE

COMMENT

Dr. Merrill's penetrating analysis brings out the fact that an economic institution of the type of a modern stock exchange involves, in spite of, and partly because of, its essentially competitive structure, at least three types of "control" of men over men. He mentions the control by mores regulating to some extent the mutual interrelationships between the individual members; next, the supervision and check exercised by the institution itself, such as by statutes and bylaws; lastly, the recently developed political control, represented in this country by the regulation of issue-prospectuses and by similar functions of the Securities Exchange Commission (since 1934).

There are at least three other major groups of far more subtle and intricate *modi operandi* in consciously influencing "the market," i.e., the behavior of the traders on an exchange. First, control by common law

in protecting contractual and other vested rights, and legal protection against criminal offense, automatically apply here too and need no mentioning, except as compared with more specific regulations to the same effect. A second set of "social constraints" comprises the influences exerted by forces of capitalism, such as the security issuing units (public authorities and corporations); the investment bankers (issue houses and distributive agencies); major security purchasers, especially of the institutional type (large insurance firms, etc.); and, lastly, commercial banks' and other (private) creditors whose attitude in providing credit—under changing conditions and at changing prices—to the exchange operators and their customers is particularly significant from the point of view of public policy because of its continuous and organized character, usually presented as the money-market background of the stock exchange. Whereby we come, thirdly, to the most intricate field of credit control by central banks or other public and semipublic organs. It is usually exerted through managing the volume and price of credit available for the purchase and sale of securities, and is part and parcel of the monetary management of the country. As direct credit control it takes two conspicuous forms: the quantitative form such as dictating margin requirements to brokers and banks and the qualitative approach of discriminative regulations about the permissible (or, in some countries, obligatory) holding of securities in institutional portfolios. Indirect credit management comprises all the factors of public policy the vector sum of which helps to determine trend and level of the market rate of interest as well as the inflationary or deflationary expectations of the community.

Thus, the analysis of the pricing process of an exchange is scarcely exhausted by mere reference to (usually unknown) supply schedules and demand curves. Such an approach may satisfy the current urge of economic theorists for mechanics-substitutes to arrive at a mechanics, rather than a causal, interpretation of the market; from the sociologist's point of view it is the interplay of numerous "controls" which naturally attracts the attention. This approach is appropriate because it tends to bring out the problems and aspects which are relevant for policy. On the other hand, however, the mere gathering and classifying of control data, or of data indicative of control, compares with sociological analysis, just about as the deciphering of old coins compares with the economic analysis of monetary history. The control approach tends to expand the meaning of its fundamental concept, until it virtually coincides with that of an all-embracing theory of social relations and threatens to lose significance for scientific or policy purposes (except as data collection).

Obviously, each individual measure or kind of control derives its respective dignity from its relevance to the essential function of the institution. There are "rules of the game" of a technical type which have to do with the efficiency of its performance (e.g., the number of securities handled per unit of time, the quick spread of information about quotations, etc.). There are issues of business ethics involved, to which Dr. Merrill seems to refer most often. In this respect sociological analysis would be extremely fruitful; but it has scarcely been attempted so far. The significance of regulations to exclude "cheating" and to insure "fair dealings" cannot be properly valued without analyzing the patterns of behavior which are characteristic of the persons involved. At any rate, the stock-exchange operators and the speculating public are far from being representatives of the typical *homo oeconomicus*; the fact that well-informed American scholars (and similarly J. M. Keynes in his latest book) tend to assign him this position is in itself a significant indication of substantial changes either in the structure of capitalism or at least in the outlook of the intelligentsia in the present phase of financial history.

Nothing short, however, of a thorough understanding of the marketing of the stock exchange permits a relevant appraisal of the different controls to which it is subjected. How far does its price-making mechanism determine or indicate the future trend of the cyclical course in production? the distribution of capital among different occupational uses? the flow of funds and the rate of interest in short-term and in long-term credits? the investment policies and the welfare of individual and institutional investors? the excess or lack of speculative urge?—to mention but a few questions. Control over the exchange, direct or indirect, receives its "meaning" from the effect it is supposed to, and actually does, exert in these directions. Laws which do not mention the exchanges—e.g., the Johnson Act of 1933—are often far more significant than elaborate rules for their members as to proper behavior. If the study of social control is not to deteriorate into the mere application of a current jargon ("that has become the stock in trade—and often the sole intellectual capital . . .")¹ it has to evolve its standards of choice between the important and the unimportant; and this can only be achieved in terms of a functional approach. Whether or not, for instance, the bylaws of an exchange are "interesting," or a matter of a collector's fancy, can only be decided upon when confronted with the mechanics of the exchange, on the one hand, and with the functional problems of its pricing process, on the other hand.

Students of the "human" as well as of the "economic" aspects of the

¹ L. Wirth, in this *Journal*, November, 1937, p. 483.

modern capital market will be gratified by Dr. Merrill's analysis of a few outstanding forms of control. But his approach points to a number of difficulties inherent in this type of study. The emphasis on the more apparent or concrete power of men over men as implied in the aspects of control which he points out is likely to deter from the more abstract and remote relationships between different markets or between markets and the institutional setups of our society. Furthermore, the focusing on an institutional body, and on the mutual relations of its components, rather than on the underlying social process, and its relevant functions, involves the risk of narrowing the explored horizon. The case of the recently introduced Security Exchange Commission and of its regulative activities is instructive indeed. Of course, they have to do with the "fairness" of dealings between seller and buyer; but this raises rather than answers questions. Assuming that the moralistic concepts implied are properly determined, the question as to the relevant aspects from the functional point of view arises. The present writer believes that the recent regulations are a wholesome method of exterminating certain abuses. But how important have the regulations proved to be even within this limited scope? And how far did they help to "bring back confidence," to "protect the public," and to achieve this "with the least possible interference to honest business," as the President's message to Congress of March 29, 1933, promised? How far did these achievements insure, as Senator Fletcher wanted in the statement accompanying the Finance Committee's bill, that "the operation of securities exchanges shall never again intensify a business depression, or help precipitate a business depression"?² The science of *Wirtschaftspolitik* consists largely of comparing the aims of a policy with its actual (or probable) results, and the same holds for the analysis of every type of organized social restraint.

Of course, the multiplicity of causes and effects may not always permit the candid investigator to arrive at definite conclusions. But it is always the privilege, if not the duty, of the scientist to avoid the effect of the current emotional heat and instead to turn the cold light of impartial reason on the scene. He would illuminate at once the biases and wishful thoughts of the quarreling interests, instead of joining without resistance, and without decisive argument, the one or the other party.

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² Quoted by H. E. Hansen, "Highlights of Stock Exchange Regulation: Hopes and Promises in Retrospect," *Annalist*, 1937, p. 783.

